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Report to Sen. Edward M. Kennedy, Chairman, Senate Committee on Human Resources: Health and Scientific Research Subcommittee; by Elmer B. Staats, Comptroller General

Issue Area: Health Programs: Health Maint. Organization's Compliance with Law (1214). their Viability as Alternative to fee-for-service mode of Producing Care

Contact: Human Resources Div.

Budget Function: Health: Health Care Services (551).

Organization Concerned: Department of Health, Education, and Welfare.

Congressional Relevance: Senate Committee on Human Resources: Health and Scientific Research Subcommittee. Sen. Edward M. Kennedy.

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The actions of the Department of Health, Education, and Welfare (HEW) in region VIII were reviewed concerning: (1) use of Federal funds for construction of a medical facility by the Neighborhood Health Center in Salt Lake City, Utah; and (2) accountability for Federal grant funds awarded to Sweetwater Health Services, Inc., in Rock Springs, Wyoming. The Neighborhood Health Center is currently being used by a federally qualified health maintenance organization (HMO), and Sweetwater Health Services was an HMO project that has been terminated. The review was prompted by allegations of mismanagement of the HMO program in region VIII, conflicts of interest involving Federal employees, and possible misappropriation of Federal funds. Findings/Conclusions: HEW's management decisions concerning grants to the Neighborhood Health Center from 1971 through 1977 were conflicting, unclear, and untimely with regard to interpretation and application of Federal regulations and policies concerning grant conditions and grant-related income, departmental policy governing construction, and clarification of the Federal interest in a medical facility constructed for the Neighborhood Health Center. Region VIII management allowed the center to collect funds from several program sources intended to pay medical care expenses of low-income consumers and to place those funds in a contingency reserve fund to construct a medical facility. These actions were contrary to HEW policy. Public Health Service headquarters officials ratified the region's decision without determining whether they complied with special grant conditions. The region

did not adequately monitor Sweetwater Health Services' grant activities to ensure that adequate accounting records and supporting documents were available; HEW was not in a position to assure that grant funds and grant-related income were properly accounted for. Recommendations: The Secretary of HEW should direct the Regional Health Administrator to: initiate collection of interest earned on grant funds by the Neighborhood Health Center, initiate collection of all unallowable grant expenditures incurred by Sweetwater Health Services, determine whether Sweetwater Health Services acted in good faith to become a federally qualified HMO, determine whether Sweetwater has an obligation to return Federal HMO grant funds, and establish management policies and procedures to prevent a recurrence of grant management problems. (RRS)

7058

REPORT BY THE

Comptroller General

OF THE UNITED STATES

Problems In Administration Of Two Health Grant Projects In Region VIII

HEW's region VIII encompasses Colorado, Wyoming, Utah, Montana, and North and South Dakota. The Chairman of the Subcommittee on Health and Scientific Research, Senate Committee on Human Resources, requested GAO to review two HEW health grant projects in the region.

GAO found that HEW allowed the use of Federal funds to

- construct a \$900,000 medical facility without adequately establishing the Federal financial interest in the facility and without assuring compliance with departmental regulations, and
- operate a developing health maintenance organization grant project without remedying known problems such as inadequate financial management.



HRD-78-61
JULY 20, 1978



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(5)

The Honorable Edward M. Kennedy
Chairman, Subcommittee on Health
and Scientific Research
Senate Committee on Human Resources

Dear Mr. Chairman:

In response to your June 16, 1976, letter and subsequent discussions with your office, we are reporting on our review of the administration of Federal funds provided to two grant projects in the Department of Health, Education, and Welfare's (HEW's) region VIII. Region VIII encompasses Colorado, Wyoming, Utah, Montana, and North and South Dakota.

We found that region VIII's management did not adequately establish the Federal Government's financial interest by allowing (1) use of Federal funds to construct a Salt Lake City, Utah, medical facility costing over \$900,000, purchase of a parcel of unimproved property and maintenance of a contingency reserve fund without requiring compliance with established regulations and special grant conditions, and (2) use of HEW grant funds by Sweetwater Health Services, Incorporated, despite the inadequacy of its accounting system and supporting documents, and region VIII management's awareness of the grantee's slow rate of progress toward becoming a qualified health maintenance organization.

During the course of our review and up to the present, HEW has been reviewing issues that are related to the matters covered in this report. We delayed the issuance of this report to include the legal and audit resolution of some of these matters by HEW region VIII, but we are reporting the results of our study without final departmental action.

Accordingly, this report recommends that the Secretary of HEW direct the Regional Health Administrator to:

- Initiate collection of the interest earned on grant funds by the Neighborhood Health Center and its successor organizations.
- Determine the amount of and initiate collection of all unallowable grant expenditures incurred by Sweetwater Health Services.

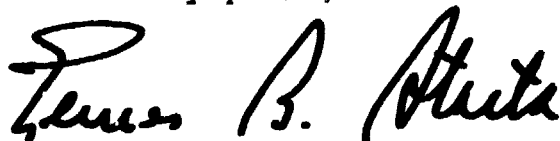
- Determine whether Sweetwater Health Services had acted in good faith toward becoming a federally qualified health maintenance organization, and in view of its voluntary withdrawal from the qualification process, whether an obligation exists to return Federal grant funds.
- Clearly establish management policies and procedures to prevent a recurrence of HEW's grant management problems similar to those identified at Sweetwater Health Services.

Your request was prompted by allegations of HEW employees that they have had personnel actions taken against them because of their disagreement with some program decisions concerning the projects discussed in this report. The Secretary of HEW, responding in April and May 1977 to inquiries from Congressman Timothy Wirth and Congresswoman Patricia Schroeder, stated that a review of the program issues raised by these individuals and the Department's alleged harrassment of them will be made after issuance of this report and remedial action will be taken as necessary.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

As arranged with your office, we are sending copies of this report to Senator Sam Nunn. Copies will also be available to other interested parties who request them.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Louis B. Blum". The signature is written in a cursive, flowing style with a large initial "L".

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE SUBCOMMITTEE ON
HEALTH AND SCIENTIFIC RESEARCH
COMMITTEE ON HUMAN RESOURCES
UNITED STATES SENATE

PROBLEMS IN ADMINISTRATION
OF TWO HEALTH GRANT PROJECTS
IN REGION VIII

D I G E S T

WHY THE REVIEW WAS MADE

At the request of the Chairman, Subcommittee on Health and Scientific Research, Senate Committee on Human Resources, GAO reviewed the actions of the Department of Health, Education, and Welfare's (HEW's) region VIII concerning

- use of Federal funds for construction of a medical facility by the Neighborhood Health Center, Salt Lake City, Utah; and
- accountability for Federal grant funds awarded to Sweetwater Health Services, Incorporated, Rock Springs, Wyoming.

The Neighborhood Health Center facility is currently being used by a federally qualified health maintenance organization, and Sweetwater Health Services was a health maintenance organization project that is now terminated.

The Chairman's request was prompted by allegations of (1) mismanagement of the health maintenance organization program in region VIII, (2) conflicts of interest involving Federal employees, and (3) possible misappropriation of Federal funds. The allegations were directed primarily toward the Neighborhood Health Center's misuse of Federal funds and Sweetwater Health Services' lack of an adequate accounting system to properly account for Federal grant funds. These allegations were raised by certain region VIII program officials who claim that adverse personnel actions were initiated against one of them because of their disagreement with some program decisions concerning

grants to the Neighborhood Health Center and Sweetwater Health Services. Based on agreements reached with the Subcommittee office, we limited our review to HEW's management of the two grant projects. (See pp. 5 and 6.)

FINDINGS AND CONCLUSIONS

Neighborhood Health Center

Region VIII allowed the Neighborhood Health Center to collect funds from several program sources intended to pay medical care expenses of low-income consumers and place these funds in a contingency reserve. In some cases, for example as with Medicaid payments, Neighborhood Health Center received funds from two sources to finance the same expense. Interest earned on funds in the contingency reserve were retained in the contingency reserve by Neighborhood Health Center.

Neighborhood Health Center used funds from the contingency reserve to construct a \$900,000 medical facility and to purchase unimproved land. Region VIII officials did not act promptly to establish fully the Federal Government's financial interest in the medical facility and other property. This situation occurred because HEW management decisions concerning grants to the Neighborhood Health Center and its successor organizations from 1971 through 1977 have been conflicting, unclear, and untimely with regard to:

- Interpretation and application of Federal regulations and policies concerning grant conditions and grant related income.
- Departmental policy governing construction.
- Clarification of the Federal interest in the medical facility. (See pp. 19 and 20.)

Sweetwater Health Services

Region VIII continuously funded Sweetwater Health Services and its predecessor organization for about 3-1/2 years with grant funds authorized under section 314(e) of the Public Health Service Act and the Health Maintenance Organization Act until Sweetwater Health Services voluntarily withdrew from the health maintenance organization program. Region VIII did not adequately monitor Sweetwater Health Services' grant activities to make sure that adequate accounting records and supporting documents were available during the last 18 months (June 1, 1974 to Nov. 30, 1975) of Sweetwater Health Services' existence. Thus, HEW was not in the position to assure that grant funds and grant-related income were properly accounted for and used in compliance with Government regulations and grant conditions. HEW Audit Agency subsequently determined that certain costs were unallowable. Furthermore, HEW funding continued even though HEW was aware that Sweetwater Health Services was making little progress toward becoming a federally qualified health maintenance organization. (See pp. 34 and 35.)

RECOMMENDATIONS

GAO recommends that the Secretary of HEW direct the Regional Health Administrator to:

- Initiate collection of the interest earned on grant funds by the Neighborhood Health Center and its successor organizations.
- Initiate collection of all unallowable grant expenditures incurred by Sweetwater Health Services.
- Determine whether Sweetwater Health Services had acted in good faith toward becoming a federally qualified health maintenance organization and, because of its voluntary withdrawal from the qualification process, whether an obligation exists to return Federal health maintenance organization grant funds.

--Clearly establish management policies and procedures to prevent a recurrence of HEW's grant management problems similar to those identified at Sweetwater Health Services.

AGENCY COMMENTS

HEW concurred with our recommendations. HEW disagreed with the implication in GAO's draft report that the regional office acted inappropriately in allowing the grantee to use grant-related income to construct a facility. However, it acknowledged that some of the income should not have been included in the reserve, but stated that there is no prohibition to establishing such a reserve. GAO is not implying that it is inappropriate to establish a contingency reserve. It is inappropriate, however, to receive funds from several governmental sources to finance the same expense and place the excess funds in a reserve to construct the facility. (See pp. 20 and 21.)

HEW did not agree with GAO's position that Sweetwater Health Services continued to be funded despite the region's knowledge that Sweetwater Health Services was not making satisfactory progress toward qualification.

GAO believes that its report sufficiently addresses the findings of Sweetwater Health Services' inadequate progress by regional staff and consultants under contract with HEW who evaluated the plan's progress toward qualification. GAO still maintains that Sweetwater Health Services' lack of progress existed over an extended period of time and, thus, consideration should have been made sooner, if not to terminate the grant, at least to assess the lack of success of the region's attempts to assist this project. (See pp. 35 and 36.)

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ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
NHC	Neighborhood Health Center
SHS	Sweetwater Health Services, Inc.
HMO	health maintenance organization
PHS	Public Health Service
OEO	Office of Economic Opportunity

CHAPTER 1

INTRODUCTION

At the request of the Chairman, Subcommittee on Health and Scientific Research, Senate Committee on Human Resources, we reviewed the actions of the Department of Health, Education, and Welfare's (HEW's) region VIII 1/ concerning

- use of Federal funds for construction of a medical facility by the Neighborhood Health Center (NHC) 2/, Salt Lake City, Utah; and
- accountability for Federal grant funds awarded to Sweetwater Health Services, Incorporated (SHS), Rock Springs, Wyoming.

The NHC facility is currently being used by a federally qualified health maintenance organization (HMO), and SHS was an HMO project (now terminated).

Our review was prompted by allegations of mismanagement of the HMO program in HEW's region VIII, conflicts of interest involving Federal employees, and possible misappropriation of Federal funds. The allegations were directed primarily toward NHC's misuse of Federal funds and SHS's lack of an adequate accounting system to properly account for grant funds. It was also charged that region VIII's management has been aware of problems with the grantees, and it was clearly implied that regional management failed to take remedial action and, subsequently, attempted to conceal the region's deficiencies in managing the two grant projects. These allegations were raised by certain region VIII program officials who claimed that adverse personnel actions were initiated against them because of their disagreement with program decisions concerning grants to NHC and SHS.

Based on agreements reached with the Subcommittee staff, we limited our review to HEW's management of the two grant projects.

1/Region VIII encompasses Colorado, Wyoming, Utah, Montana, and North and South Dakota.

2/Neighborhood Health Centers are now officially called Community Health Centers.

FEDERAL GRANT PROGRAMS FOR HMOs

In his February 1971 and March 1972 health messages to the Congress, the President encouraged the establishment of HMOs as an alternative to traditional fee-for-service health care delivery systems. Consistent with that objective, starting in 1971, HEW allocated about \$31 million under sections 304, 314(e), and 910(c) of the Public Health Service (PHS) Act (42 U.S.C. 242(b), 246, 299(j)) for research, development, evaluation, and technical assistance to aid prototype HMOs. Also, during fiscal years 1971-73, the Office of Economic Opportunity (OEO) provided about \$42.6 million under the Economic Opportunity Act (42 U.S.C. 222(a)(4)) for a program of developing and/or subsidizing community health networks. These networks were intended to have many characteristics of HMOs and were designed to market prepaid health plans to low-income, near poor, and nonpoor consumers.

The HMO Act of 1973 (42 U.S.C. 300e), approved December 29, 1973, amended the PHS Act to provide a trial Federal program to develop alternatives to traditional forms of health care delivery and financing by assisting and encouraging the establishment and expansion of HMOs.

The act authorizes grant funds for feasibility studies, planning and initial development activities, and loans for operational assistance after an organization becomes a federally qualified HMO.

As of June 30, 1977, HEW had awarded grant and loan funds under the act totaling \$98.6 million to 168 organizations. Of the 168 organizations, the 15 in region VIII were awarded a total of \$2.5 million in grant funds. Five of the 15 organizations also received PHS 314(e) grants totaling \$0.7 million. HEW's regional organizations are to monitor and assist the grantees.

FAMILY HEALTH PROGRAM OF UTAH

The Family Health Program became a federally qualified HMO in July 1977. Its health centers in Salt Lake City, Utah, were originally developed as neighborhood health centers beginning in 1970. The primary predecessor organization, NHC, was formed through the efforts of the Community Health Centers Foundation, Salt Lake City, Utah, a project jointly funded in 1970 and 1971 by OEO and PHS for the purpose of developing and operating neighborhood health centers in the Salt Lake City area.

NHC began delivering prepaid medical services to low-income consumers in July 1971 through a medical clinic which was located in central Salt Lake City south of the main business district. As a subgrantee of Community Health Centers Foundation, NHC received OEO and PHS grant funds to provide low-cost medical care to persons in the Salt Lake City area who were not eligible for Medicaid or Medicare services under the Social Security Act. NHC described itself as an "HMO for poor people."

In 1972 NHC continued to receive PHS grant funds to provide medical care to low income consumers. It also received OEO grant funds as a subgrantee of the Community Health Centers Foundation until December 1972 when Federal funding of the Foundation terminated.

During 1972 NHC also received PHS approval to expand into southern Salt Lake County. It purchased land south of the Salt Lake City central business district in a suburban area and awarded a contract effective September 28, 1972, for construction of a second medical clinic which was completed in December 1973. The purchase of land and construction of the medical facility were financed from Federal funds held in a contingency reserve. (See pp. 7, 8 and 9.)

Merger negotiations during 1973 between NHC and Group Health Association of Utah (a PHS grantee in 1972 and 1973) resulted in the formation of the Utah Group Health Plan, which assumed operations of the two medical clinics. Utah Group Health Plan continued to receive grants under section 314(e) of the PHS Act for its health center activities and under title XIII of the act for HMO activities.

In 1975 Utah Group Health Plan began exploring a merger with Family Health Program of California and in January 1976, transferred management operations of the two medical clinics to the Family Health Program. The merger was later completed and on July 1, 1976, Family Health Program assumed full responsibility for all former Utah Group Health Plan activities.

The table on page 4 shows total Federal grant awards and the grantee's reported expenditures for NHC activities through April 1977. It includes awards to Family Health Program of Utah and its predecessor organization, Utah Group Health Plan.

Summary of Grant Awards and Expenditures

<u>Grant period</u>	<u>PHS Act section 314(e)</u>		<u>Economic Opportunity Act section 222a</u>	
	<u>Grant awards (note a)</u>	<u>Grant expendi- tures</u>	<u>Grant awards</u>	<u>Grant expenditures</u>
5/70-12/70	\$ 328,910	\$ 253,022	\$ 424,839	\$ (b)
1/71-12/71	1,000,000	509,585	807,544	317,076
1/72-12/72	1,611,000	1,911,000	c/750,000	737,208
1/73-12/73	2,557,220	2,354,586	-	-
1/74- 3/75	2,385,249	2,695,038	-	-
4/75-12/75	1,612,686	1,612,686	-	-
1/76- 4/76	687,314	675,583	-	-
5/76- 4/77	2,279,880	(d)	-	-
Total	<u>\$12,462,259</u>	<u>\$10,011,500</u>	<u>\$1,982,393</u>	<u>\$1,054,284</u>

a/Excludes carryover of grant funds from prior budget period(s) available for expenditure.

b/Grant expenditures were not shown in available data.

c/OEO funding ended with the 1972 calendar year award. Grant expenditures of \$737,208 includes \$272,456 added to the contingency reserve fund. (See pp. 9 to 11.)

d/Expenditure report was not available for the grant period.

SWEETWATER HEALTH SERVICES, INCORPORATED

SHS was incorporated in June 1, 1972 as a nonprofit corporation to develop and operate a prepaid health care plan in Sweetwater County, Wyoming. During the first 2 years of Federal grant assistance, SHS was a subgrantee of Wyoming Health Services and was not directly responsible to HEW for grant funds. Wyoming Health Services was formed by the Wyoming State Medical Society to study the feasibility of HMOs in Sweetwater County. It received two Federal grants beginning in April 1972 to develop an HMO. Effective June 1, 1974, responsibility for the second grant was transferred to SHS.

HEW grant funds awarded and reported as expended by Wyoming Health Services and SHS are summarized as follows:

<u>Organization and grant period covered</u>	<u>Funding source</u>	<u>Grant awards</u>	<u>Reported expenditures</u>
Wyoming Health Services:			
1/ 1/72 - 12/28/73	sec. 314e PHS Act	\$ 50,000	\$ 50,000
1/ 1/73 - 5/31/74	sec. 314e PHS Act	<u>a/129,749</u>	<u>129,749</u>
Total		\$179,749	\$179,749
SHS:			
6/ 1/74 - 10/31/74	sec. 314e PHS Act	<u>a/21,068</u>	25,718
10/ 1/74 - 9/30/75	HMO Act	205,781	157,072
10/ 1/75 - 11/30/75	HMO Act	<u>(b)</u>	<u>22,682</u>
Total		\$226,849	\$205,472
Grant Total		<u>\$406,598</u>	<u>\$385,221</u>

a/Total award to Wyoming Health Services for this period was \$150,817. Unobligated balance of \$21,068 was transferred to SHS.

b/Period of previous award extended without additional funding.

The SHS Board voted to withdraw from the program effective October 31, 1975. On November 14, 1975, HEW formally notified SHS that it had not demonstrated the capability to become a federally qualified HMO.

SCOPE OF REVIEW

Our review, which was conducted at HEW headquarters, the region VIII office in Denver, the State of Utah Department of Social Services, and the Family Health Program office in Salt Lake City, included

- an examination of reports and workpapers of HEW internal auditors,
- an examination of reports of certified public accounting firms which audited the grantees,
- an examination of selected accounting and statistical records of the Salt Lake City grantees,

--a review of HEW records and files, and

--discussions with officials of HEW, the former OEO, the grantee, and the State of Utah Medicaid program.

As noted on page 1, certain adverse personnel actions were initiated against one of the region VIII program officials who brought the allegations of HMO program mismanagement to the attention of the Chairman, Subcommittee on Health and Scientific Research, Senate Committee on Human Resources. We did not address these charges because such personnel actions are, in our opinion, an internal matter that should initially be handled by HEW.

CHAPTER 2

FEDERAL FUNDS USED TO CONSTRUCT MEDICAL FACILITY

WITHOUT FEDERAL FINANCIAL INTEREST BEING

ADEQUATELY ESTABLISHED

The Department of Health, Education, and Welfare's management decisions concerning grants to the Neighborhood Health Center and its successor organizations from 1971 through 1977 have been conflicting, unclear, and untimely with regard to

- interpretation and application of Federal regulations and policies concerning grant conditions and grant related income,
- departmental policy governing construction, and
- clarification of the Federal interest in a medical facility constructed for NHC.

USE OF FEDERAL FUNDS FOR CONSTRUCTION OF A MEDICAL FACILITY

Significant amounts of Federal funds, earmarked for the provision of medical services, were used to construct a medical clinic costing over \$900,000 to serve low-income consumers of the South area of Salt Lake County. NHC was able to finance and build the new medical facility with Federal funds because region VIII management

- approved NHC's request to establish and place in a contingency reserve fund, grant-related income, such as Office of Economic Opportunity grant moneys and Medicaid reimbursements, without region VIII management requiring NHC to stipulate the intended use of the fund;
- allowed NHC to use the contingency reserve fund for construction of a medical clinic and purchase of adjacent unimproved land without requiring compliance with OEO special grant conditions and provisions for construction; and
- awarded NHC a Public Health Service grant to supplement the cost of medical care to low-income consumers without stipulating that other funds, such as Medicaid receipts, received for this same purpose be used before using PHS grant funds.

Establishment of a contingency reserve fund

In a December 13, 1971, letter to HEW, the NHC Director requested written confirmation of the PHS regional project officer's earlier verbal authority to use grant related income according to alternative 2 of the HEW Grant Administration Manual. 1/ Alternative 2 stated that such income could be used to further the purposes of the PHS grant program for which the award was made. The regional project officer, who was also the Regional Director, Office of Grants Management, confirmed this agreement by letter on December 21, 1971. However, neither letter stipulated the planned use of the funds nor mentioned NHC's intention of establishing a reserve fund to construct a medical clinic.

Our review of records disclosed the source and use of the funds establishing the contingency reserve. As noted in the following table, most of the funds came from governmental sources. Our analysis and a prior HEW analysis (see pp.14 to 16), of the method used by NHC to create this reserve fund indicate HEW management lapses in assuring continuous application of Federal regulations and contractual agreements affecting Federal grant and Medicaid funds.

Our analysis of records regarding contingency reserve fund receipts and expenditures from December 1971 through March 31, 1975, and the remaining balance at that date are summarized in the following table.

1/The HEW Grants Administration Manual, ch. 1-420, defined grant-related income as "Income derived by a grantee organization from activities conducted under the auspices of the grant supported activity. Such income may be produced by the services of individuals or by employing equipment, facilities or general services of the grantee organization."

<u>Receipts</u>		<u>Expenditures</u>	
Government sources:			
Medicaid (note a)	\$603,260	Land (clinic II)	\$162,167
OEO grant (note b)	272,456	Land improvements	
314(e) PHS grant	60,000	(clinic II)	62,204
Miscellaneous	28,279	Building	
(note c)		(clinic II)	715,198
Total	\$ 963,995	Total (clinic II)	939,569
Nongovernment sources:			
Medical care		Leasehold improve-	
receipts	\$ 99,146	ments (clinic I)	9,934
Interest income	6,405	Total	\$949,503
Miscellaneous	437	Reserve balance	\$180,480
Total	\$ 165,988		
Total	\$1,129,983		

a/Medicaid payments were made by the State of Utah, but, in accordance with the State health plan, these payments are financed primarily from Federal funds.

b/Based on approximately 1,875 enrollees at \$12.33 per month for 12 months.

c/Represents other Federal program revenue (\$1,537) and Medicare receipts (\$26,742).

Most of the receipts placed in the reserve represented calendar year 1972 income to NHC. The majority of the Medicaid receipts were received on a capitation basis (a uniform fee applied to a monthly estimate of the number of eligible patients) under a prepayment plan contract with the State of Utah.

Portion of contingency reserve fund from OEO grants

NHC received, as a subgrantee of the Community Health Centers Foundation, a \$750,000 OEO grant for the period January 1, 1972 to December 31, 1972, to provide medical care to an estimated 1,875 low income patients. The award was based on a prepayment capitation fee of \$33.33 a month per enrollee.

In a June 5, 1972, letter, the NHC Director advised the PHS project officer that \$21 of each \$33.33 capitation fee was being used to cover the expected medical care expenses of OEO patients and the balance, \$12.33, was being added to

the reserve as grant-related income. The NHC Director stated that the \$12.33 would provide \$277,425 toward a contingency reserve, and an additional \$722,575 would be added from other program generated income. He also stated that \$600,000 of the reserve would be used for a second medical clinic located in the southern part of the Salt Lake City Area. The letter implicitly requested approval of the method of accounting for OEO funds. In his June 13, 1972, response, the PHS project officer approved the method of accounting for OEO funds but made no comment about using the reserve for a second clinic.

NHC also received \$300,000 from an OEO grant for calendar year 1972. This award included \$250,000 for developing plans and constructing a medical clinic and \$50,000 for equipping the new clinic. The award of construction funds was contingent on NHC meeting the OEO special grant conditions set forth in the grant award. These included conditions requiring (1) the Community Health Centers Foundation and NHC to execute agreements which set forth the Government's rights and residual interest in any facility purchased, constructed, or renovated with Government funds, and (2) that the Community Health Centers Foundation obtain prior written OEO approval for each stage of planning and construction.

In May 1972 OEO deobligated the \$300,000 grant for construction and equipment since neither the Community Health Centers Foundation nor NHC had begun to meet the special grant conditions. In a May 30, 1972, letter to the Community Health Centers Foundation, OEO stated that it would consider reawarding up to \$300,000 if requested by NHC, and evidence was furnished showing that the special grant conditions were met before December 31, 1972. A letter which OEO issued to the NHC Director on June 30, 1972, shortly before OEO's responsibilities for NHC were transferred to HEW, stated that OEO was not willing to make the withdrawn \$300,000 available to the project. However, it would concur in reallocating a portion of the fiscal year 1972 funds budgeted for health services (i.e., the \$750,000 capitation grant) to facility development if:

- prior PHS approval was obtained,
- health services for current OEO enrollees in NHC continued without reduction,
- funds from all other possible sources of financing were unobtainable, and
- no more than \$300,000 was reallocated.

As discussed on p. 9, NHC requested and received approval from the PHS project officer to allocate a portion of the \$750,000 capitation grant to the contingency reserve fund.

However, the PHS project officer's approval of NHC's accounting methods for OEO funds occurred on June 13, 1972, prior to OEO's June 30, 1972, letter permitting reallocation of such funds. Also, the PHS project officer made no reference to the OEO special grant conditions.

Effective July 1, 1972, by interagency agreement, HEW was assigned responsibility for managing the 1972 OEO grant in addition to managing the PHS grant. All Regional Health Directors were advised that OEO grant conditions and policy guidelines were to be followed for the remainder of the grant budget period for OEO grants transferred to HEW. Additional HEW guidelines were provided for administering OEO grants which required that OEO special grant conditions for construction, such as those included in the 1972 OEO grant to NHC would be carried out by the Health Services and Mental Health Administration. Consultation and technical assistance would be done on a regional basis by HEW's Facilities Engineering and Construction Agency. All regional engineers were advised of this policy. However, region VIII management circumvented this departmental policy governing construction by failing to carry out these special grant conditions on facilities construction and also by failing to notify the regional engineers about the NHC construction project. Furthermore, a note from OEO to HEW in March 1973 states that the OEO special grant conditions were not met.

Request for additional construction funds

In September 1972 the NHC Director wrote the PHS project officer that the first phase of the second medical clinic construction had to be completed by August 1973. This required, in addition to funds accumulated in the contingency reserve, about \$250,000 for basic medical equipment. He requested approval to set aside \$250,000 from OEO funds budgeted for facility development. The PHS project officer approved the request on September 22, 1972, stating in part that the \$250,000 would be considered as partly meeting OEO's commitment of up to \$300,000 for facility development. Instead of rebudgeting 1972 OEO funds for equipment, \$250,000 was included in the calendar year 1973 PHS section 314(e) grant award for this purpose. This award was later revised to provide \$379,023 for equipment and \$60,000 for construction.

Following the September 22, 1972, approval, the NHC Director forwarded a copy of a signed construction contract to the regional project officer on September 28, 1972. The NHC Director stated that the contractor had some apprehension about whether all Federal requirements had been met. The regional project officer replied that his office did not need to approve the contract because Federal grant funds were not involved. However, as now stated in a July 1977 opinion by the HEW region VIII attorney, grant related income was involved. Because of the conditions set by OEO, we believe that HEW should have reviewed the contract to assure that Federal requirements were met.

Portion of contingency reserve fund from PHS grants and Medicaid payments

NHC received \$1,911,000 in PHS section 314(e) grant funds during 1972 to provide for the cost of medical services incurred above that covered by other sources of funds. The grant award stipulated that none of these funds may be used for site acquisition, construction, remodeling, renovation, or equipment for a second medical clinic facility in the southern Salt Lake City suburban area.

NHC, in its 1972 PHS grant application, estimated a requirement of \$3,325,000 for the provision of medical services. Its estimate did not include any provision for construction or a contingency reserve. In addition to a \$1,911,000 PHS grant, the \$1,414,000 balance was to be funded from the following fund sources:

Salt Lake County contribution	
of clinic space	\$ 64,000
Title XIX Medicaid	560,000
OEO	750,000
Other	<u>40,000</u>
Total	<u>\$1,414,000</u>

NHC's Medicaid agreements for 1971 and 1972 with the State of Utah's Department of Social Services provided that NHC would receive \$18.00 each month for every Medicaid enrollee. Our analysis of records indicates that total Medicaid receipts received from the State of Utah for 1971 and 1972 were \$78,678 and \$545,525, respectively.

None of the Medicaid funds received during 1972 were used to pay either the expense of providing medical care to the Medicaid patients enrolled under the prepayment agreement with

the State of Utah or other NHC operating or administrative expenses. These expenses were financed primarily from OEO and PHS operating grant funds, while Medicaid receipts were placed in the contingency reserve fund. Thus, NHC received funds from two sources to finance the same expense--financing the cost of medical care to Medicaid patients--once under a prepayment agreement with the State of Utah and again from the PHS grant.

In an August 1971 letter, the Regional Health Director advised the Acting Executive Director, Community Health Centers Foundation, that PHS grant funds for NHC cannot be used to pay for the cost of health care services to Medicaid patients. The letter was signed by the PHS project officer. The letter stated that payment should be secured from third-party agencies, including Medicaid, for covered health care services provided beneficiaries of such third-party agencies, through PHS grant-aided health care centers.

PHS grant funds may be used only to supplement the cost of providing medical services to Medicaid patients and are not to be used to pay 100 percent of the cost when Medicaid funds to provide such care are available. A State official, responsible for administering the Medicaid program, told us that the State's principal concern was that Medicaid patients received the health benefits to which they were entitled. As long as this was done, he was not concerned about how the Medicaid funds were used unless the funds were used in violation of a Federal regulation.

Although no 1972 Medicaid funds were used to pay medical care expenses, available data for the last 6 months of calendar year 1972 showed that Medicaid patients accounted for about 34 percent of the patients receiving medical care from the first NHC clinic.

The PHS project officer, by not obtaining assurances on how the PHS grant funds and Medicaid payments were administered, allowed NHC to use PHS grant funds to pay for the cost of medical care to Medicaid patients, while Medicaid receipts were being placed in the contingency reserve fund.

In January 1973 responsibility for administering the PHS grant to NHC was assigned to a different region VIII official. Questions were raised regarding the propriety of certain actions of the former project officer, and this official requested headquarters advice. According to his memorandums, telephone discussions in March and June 1973 between this official and headquarters grants management

officials indicated headquarters belief that there was no problem in financing the construction of a second medical clinic with Medicaid and OEO funds included in the contingency reserve. The region was advised in the June discussion that the Government's interest in the new clinic was limited to the grant dollars used to pay construction costs.

The headquarters Office of Resource Management, Grants and Contracts, in consultation with the headquarters Office of General Counsel advised the Deputy Regional Health Director (the official responsible for the NHC grant in 1973) by a July 10, 1973, letter, that

- \$60,000 of the 1973 PHS grant (\$250,000) budgeted for equipment could be rebudgeted for construction,
- grant related income accumulated in a contingency reserve from OEO and Medicaid capitation payments could be used for construction, and
- the newly formed organization, Utah Group Health Plan (see p. 3), resulting from a merger of NHC with the Group Health Association of Utah would own the facility.

This letter was forwarded to the NHC director in August 1973.

These discussions and correspondence cited the OEO construction commitment to the NHC as a basis for the approvals. However, none of these discussions or correspondence mentioned the need for NHC to comply with the OEO special grant conditions described on page 10 before beginning the NHC construction project.

HEW AUDIT AGENCY AUDIT OF UTAH GROUP HEALTH PLAN

In July 1974, the Regional Health Administrator requested that HEW Audit Agency audit Utah Group Health Plan. The request specifically asked that the Audit Agency review activities pertaining to the contingency reserve fund and construction of the medical facility. The Audit Agency reported its tentative findings to the Regional Health Administrator in November 1974, and questioned (1) whether grant related income committed for use as cost sharing, could be accumulated in a reserve account and used for construction; and (2) whether the Federal Government has a vested interest in the title to the constructed facility. The tentative audit findings were referred to the regional attorney and the headquarters Office

of General Counsel for comment. The Office of General Counsel advised the regional attorney in January 1975 that:

- Section 314(e) grants can fund construction for any project transferred from OEO to the extent that construction was part of the OEO project plan prior to that transfer.
- Grant-related income may be retained by the grantee to develop and maintain a reserve fund to be used in offsetting underestimates of funding needs for approved project activities.
- Grant funds and grant-related income, with the exception of interest earned on grant funds, may be used for the purposes and in the manner described in the audit report.

The regional attorney furnished these comments to the Regional Health Administrator in January 1975. His letter stated that although the use of Federal funds to construct the Utah Group Health Plan (formerly NHC) clinic could be legally supportable, it was done against department policy; and while the Government may not be able to recover the money or obtain title to the clinic, some type of assurance that the facilities will be used for public health services for a substantial time period was warranted. The regional attorney suggested that a deed requiring such use for 30 years would serve this purpose.

On April 2, 1975, a quit claim deed was executed by region VIII and Utah Group Health Plan via a local title company which left title to the clinic with the grantee. However, it included a provision that, for a period of 20 years (beginning January 1, 1975), the property must be used continuously as a medical or medical and dental facility. The unimproved portion of the land was excluded, apparently as a bargaining issue to obtain execution of the deed.

The HEW Audit Agency released its final report in April 1975 with the following recommendations:

- Region VIII officials should more closely review grantees' requests for permission to use grant funds and grant-related income and insure that the decisions reached comply fully with applicable laws and regulations. (The report merely stated that under HEW policy, use of grant-related income for construction was questionable.)

--The Administrator, with appropriate legal counsel, should determine ownership of the constructed facilities and take action based on that determination.

The Regional Health Administrator, in May 1975 comments to the Audit Agency's final report, agreed that the construction and reserve approvals reflected questionable judgments but stated that the regional attorney's comments indicate that there was an adequate legal basis for approval of the construction activity. He also referred to the April 2, 1975, quit claim deed discussed in the Audit Agency's final report.

Region VIII officials requested additional information on the contingency reserve fund from the grantee. Utah Group Health Plan responded with a summary of contingency reserve receipts and expenditures as of March 31, 1975. Neither the grantee's summary nor the Audit Agency's workpapers or report indicated the amounts received from the various fund sources included as grant related income.

REGIONAL ATTORNEY OPINION--MEDICAL CLINIC AND CONTINGENCY RESERVE BALANCE

In letters to the regional attorney in December 1975 and March and April 1976, the PHS staff asked several questions about the legal consequences of a potential merger between Utah Group Health Plan and Family Health Program. Included were questions about the accumulated contingency reserve, the status of the unimproved land not covered by the quit claim deed, and the effect of the merger on the deed.

The regional attorney responded in March 1976 that, if the laws of the State which governed the merger were similar to Utah's laws, the deed provision requiring use of the facilities for 20 years for medical purposes would still apply. He also stated that since the deed does not clearly express the intent that title to the facility is to revert to the United States if the titleholder ceases to receive Federal financial assistance, it must be concluded that the titleholder may retain the clinic even though it does not receive such assistance, so long as it continuously uses the facility as a medical or a medical and dental facility.

The Regional Health Administrator wrote the regional attorney in April 1976 requesting a legal review and opinion to clarify the Federal interest in the medical clinic, the unimproved land, and the contingency reserve fund balance. The regional attorney advised the Regional Health Administrator in May 1976 that to furnish the requested legal assistance, additional information was needed such as

- copies of grant award and related documents,
- dates of acquisition of improved and unimproved property,
- source of funds used to purchase the property, and
- dates and sources of funds used to accumulate the contingency reserve balance.

In June 1976 the additional information, except for that concerning the sources of funds used to purchase the property, was furnished the regional attorney. We supplied information obtained in our review on the source and application of funds accumulated in the contingency reserve for property purchase and facility construction (see p. 9) to the Regional Health Administrator in December 1976.

The regional attorney issued a legal opinion on July 8, 1977, in response to the Regional Health Administrator's request for legal assistance. The legal opinion stated that the delay in responding was due in part to the complexity and number of issues involved, and the volume of documents reviewed. The regional attorney, in commenting on region VIII management's authority to execute the April 2, 1975, quit claim deed, stated that:

"* * * Government agents have no authority to give away the money or property of the United States, either directly or by the release of the Government's vested rights, unless authorized by Congress. Thus the Government agents administering the grants involved in this case and taking action with respect to the deed had no power or authority to release any of the Government's vested rights. Accordingly, the execution of the deed could not have constituted a release of any of the Government's interests in the unimproved land or the remaining funds in the Building Fund."

However, the regional attorney, in summarizing the Federal Government's interest in the medical clinic and unimproved land, maintained that since all funds for acquisition of the medical clinic and adjacent unimproved land came from the contingency reserve fund, those properties must be used for their entire useful life to further the purposes of the PHS 314(e) grant program. If PHS officials determine that the medical facility, including the unimproved land, is not being

used continuously for its entire useful life to serve low-income patients (with or without Federal funding), the Federal Government would have a right to recovery of the then present value of the properties.

As to the clinic property covered in the April 2, 1975, quit claim deed, the regional attorney stated that

"HEW may enforce compliance with the Conditions as set forth in the deed, including the requirement that the owner continuously operate a medical or a medical and dental facility on the premises, but HEW may not, by the authority of the deed, require the owner to provide medical services to persons unable to pay for the services." (Emphasis supplied.)

The regional attorney advised the Regional Health Administrator that all interest generated by grant funds, including OEO grant funds and the \$60,000 PHS 314(e) construction grant, must be returned to the Federal Government. He stated that the balance remaining in the contingency reserve fund (excluding any interest income) is grant-related income under the PHS 314(e) grant. The regional attorney concluded that maintenance of the contingency reserve is not contrary to the purpose of the PHS grant, provided it is being used to offset misestimates of funding needs for approved project activities or to further the purposes of the PHS 314(e) grant program.

In a July 14, 1977, letter to the current grantee, Family Health Program, the Regional Health Administrator stated that, based on the the attorney's opinion:

"* * * the Federal government has an interest equal to the full value of the building and adjacent unimproved property. In addition, the interest on any Federal grant dollars in the reserve funds belongs to the Federal government."

The Regional Health Administrator informed us in August 1977 that region VIII planned to request the HEW Audit Agency's assistance in determining the amount of interest in the contingency reserve fund due the Federal Government and attempt to recover that amount from the grantee. HEW Audit Agency on April 25, 1978, recommended recovery of \$62,170.

As part of our review, we obtained data on daily patient encounters in the second medical clinic for December 1976 through March 1977 to determine whether the clinic was

operating to serve low-income patients. Our analysis was limited to February and March 1977 because of the volume of information. Our detailed analysis showed that over half of the patients were low-income consumers. This indicates, in our opinion, that the clinic operations at that time were consistent with the purpose of the PHS grant program.

The Regional Health Administrator informed the grantee in the July 14, 1977, letter that the Federal right of recovery would not be exercised since the property was being used for the purpose for which it was acquired. The Regional Health Administrator told us in August 1977 that the region will allow the grantee to continue to operate the medical facility provided the grantee is serving low-income patients.

In accordance with the regional attorney's legal opinion, the unimproved property, surveyed out by HEW in the quit claim deed negotiations must also be used to further the purposes of the PHS grant program. While, a vacant lot is not, in fact, being used to further the purposes of the PHS grant program, the Regional Health Administrator informed us in May 1978, that the unimproved property would be used for additional office space and parking facilities to support clinic operations as it expands.

CONCLUSIONS

HEW region VIII management allowed NHC to collect funds from several program sources intended to pay medical care expenses of low-income consumers and to place those funds in a contingency reserve fund to construct a medical facility. The actions of NHC were contrary to HEW policy as acknowledged by HEW officials. Also, PHS headquarters officials ratified the region's decision apparently without determining whether NHC complied with the OEO special grant conditions. Since OEO's construction commitment was contingent on NHC meeting the special grant conditions for construction, the transfer of OEO's grant responsibilities to PHS did not, in our opinion, preclude PHS from requiring that NHC honor those conditions prior to allowing construction of the medical facility. Although the method of acquisition and subsequent use made of the funds were apparently within legal bounds, we believe that such action was not straightforward and circumvented the intended purpose of the applicable programs and, therefore, represented an inappropriate use of funds. In some cases, for example as with Medicaid payments, NHC received funds from two sources to finance the same expense. Since the PHS grant funds were used to pay the medical care expenses of Medicaid patients, the 1972 PHS grant should have been reduced accordingly when Medicaid funds were available.

Also, region VIII officials did not act promptly to establish fully the Federal Government's financial interest in the medical facility and other property that was financed with contingency reserve funds. We believe that if management had acted prudently the Federal financial interest in the medical facility and other property would have been established either prior to or at the time of facility construction. Furthermore, region VIII management should collect all interest accumulated from Federal funds placed in the reserve and should not allow the grantee to continue to accrue and maintain interest earned on grant funds in the reserve.

Since the medical clinic is operating in accordance with its intended purpose, we agree with HEW's decision to allow the grantee to continue to operate the medical facility to serve low-income patients.

RECOMMENDATION TO THE SECRETARY OF HEW

We recommend that the Secretary of HEW direct the Regional Health Administrator to initiate collection of the interest earned on grant funds by NHC and its successor organizations.

AGENCY COMMENTS AND OUR EVALUATION

The Department agreed with our recommendation. The Department stated that the grantee has been notified in writing that the interest earned on grant funds would have to be refunded and following the determination of the exact amount to be refunded, collection actions would be initiated. Subsequent to the Department's response, we were informed that the interest had been determined to be \$62,170.

HEW disagreed with the implication in our report that the regional office acted inappropriately in allowing the grantee to use grant-related income to construct a facility. However, it acknowledged that some of the income should not have been included in the reserve, but stated that there is no prohibition to establishing such a reserve.

We are not implying that it is inappropriate to establish a contingency reserve. It is inappropriate, however, to receive funds from several governmental sources to finance the same expense, and place the excess funds in a reserve to construct a facility.

Furthermore, it is not sound management to allow a project with substantial Federal funding to construct a medical facility, purchase a parcel of unimproved property, and maintain a contingency reserve fund without fully establishing the Federal Government's financial interests beforehand.

CHAPTER 3

INADEQUATE ACCOUNTING SYSTEM AND INEFFECTIVE

MANAGEMENT RESULTED IN DEFICIENT

GRANTEE PERFORMANCE

Region VIII continuously funded Sweetwater Health Services, Incorporated, and its predecessor organization for about 3-1/2 years with grant funds authorized under section 314(e) of the Public Health Service Act and the Health Maintenance Organization Act until SHS voluntarily withdrew from the HMO program. However, region VIII did not adequately monitor SHS grant activities to assure that adequate accounting records and supporting documents were available during the last 18 months (June 1, 1974 to Nov. 30, 1975) of SHS existence. Thus, HEW was not able to assure that grant funds and grant-related income were properly accounted for and used in compliance with Government regulations and grant conditions. Furthermore, HEW funding continued even though HEW was aware that SHS was making little progress toward becoming a federally qualified HMO.

Applications for HMO qualification and Federal loan financing were made by SHS in May and August 1975. Following a site visit in September 1975, the Office of HMO Qualification and Compliance informed SHS that 200 to 250 members would have to be enrolled and physician participation would have to be increased before a qualification decision could be made. SHS was informed by region VIII officials that the grant would be terminated unless it became a qualified HMO by November 30, 1975.

Following unsuccessful efforts to meet the qualification requirements or to obtain additional Federal financial assistance, the Board of Directors voted to terminate the project effective October 31, 1975. The termination date was later extended to November 30, 1975, to close out the grant activities.

INADEQUATE ACCOUNTING FOR GRANT FUNDS

Although a \$205,781 grant award (see p. 5) to SHS for the period October 1, 1974 to September 30, 1975, contained a special condition that an adequate accounting system must be developed and implemented within 30 days of the notice of grant award (Oct. 16, 1974), SHS accounting records and supporting documentation were inadequate to assure that grant funds and

grant-related income had been properly accounted for and used in compliance with the special grant conditions and the HMO Act and grant-funding regulations.

Indications of the need to monitor SHS accounting system

Region VIII staff discussed the need for an adequate accounting system for Federal grant funds with SHS officials on several occasions. On a July 15, 1974, site visit to SHS, the region VIII HMO financial analyst discussed with SHS officials the need to establish an accounting system to properly account for Federal grant funds. In August 1974 SHS informed region VIII staff that an accounting system for Federal grant funds was established with the assistance of a certified public accountant. However, region VIII staff in subsequent site visits did not review the accounting records and supporting documents until November 1975 to insure that an acceptable accounting system had been developed to account for Federal grant funds.

The initial indication of the need to monitor SHS accounting system was a recommendation by an HEW committee that visited SHS in August 1974 to evaluate its application for a \$215,381 grant. The committee, made up of HMO headquarters and regional office program officials, recommended that the award include the following condition:

"The grantee must develop and implement within 30 days of Notice of Grant Award an accounting system and documentation procedures which will protect the financial interests of the Federal government related to this grant."

As previously noted, this condition was included in the grant award document.

Another indication of the need to monitor the SHS accounting system was comments included in an HEW Audit Agency report dated September 3, 1974. This report stated that the audit agency's limited survey disclosed that policies, procedures, and systems formulated by SHS after receiving accounting responsibility for the grants in June 1974 included the following weaknesses:

--Accounting personnel had no experience with the accounting system devised by an independent certified public accountant.

--The accounting system allowed Federal funds to be commingled with non-Federal funds.

--Formal inventory records were not maintained and equipment was not tagged for identification.

The Regional Health Administrator explained in his response to the Audit Agency report that weaknesses in the SHS management, accounting system, and property inventory were due partly to lack of experience in administering Federal funds. He said that these matters had been discussed by telephone with the grantee, and that the HMO program staff would follow up to see that these matters were resolved during a site visit planned for the week of October 28, 1974.

The first visit to SHS following the Administrator's response was made by the regional HMO financial analyst and a grants management specialist in December 1974. The report on this visit states that considerable time was spent discussing a November 18, 1974, letter from the HMO financial analyst in which the requirements of an adequate accounting system were again described. However, the grantee's available accounting records and supporting documents apparently were not examined in sufficient detail to discover deficiencies that existed in implementing the system. Region VIII staff made several site visits after December 1974, but deficiencies in the grantee's accounting system and supporting documentation were not again noted until a November 1975 site visit by regional and central office staffs. Although the purpose of this visit was to examine the grantee's fiscal status and to make programmatic decisions concerning the closing out of the grant, questions arose about the propriety of certain financial transactions which prompted a request to examine the grantee's accounting records. A report on this visit by the regional and headquarters staff members stated that a perusal of the ledger, journal, and supporting vouchers revealed deficiencies such as:

--No adequate bookkeeping system to record grant expenditures between June and October 1974 existed.

--Accounting records maintained after October 1974 were incompletely posted and numerous adjusting entries were made by the C.P.A. firm's auditors during a June 1975 audit to accurately show account balances.

--Travel expenses for spouses of the Project Director and the Business Manager had been charged to grant funds.

--No monthly or quarterly financial statements were prepared and no reports of any kind had been submitted to the Board of Directors.

In addition to the region's inadequate followup on the accounting system weaknesses reported by the audit agency, the region VIII Grants and Contract Management Branch did not adequately follow up on the grantee's failure to render expenditure reports when due. In December 1974 SHS was furnished forms and advised that a report on expenditures for the period June 1, 1974, through October 31, 1974, was due by March 1, 1975. When the required report was not received, there was no followup by the region until October 1975, about 8 months after the report was due. An expenditure report for this period was not received until July 1976 when reports were received for all three SHS grant periods.

Audits of SHS financial activities after inadequacies were recognized

After the inadequacy of the SHS accounting records and supporting documentation became apparent to regional and headquarters staff in November 1975, the regional office recommended that the Board of Directors initiate an audit at once. Arrangements were eventually made for a local C.P.A. firm to make such an audit with assistance from a representative of the region VIII HEW Audit Agency. An audit was made covering the 18-month period--June 1, 1974, to November 30, 1975.

The C.P.A. firm, prior to its regular financial audit report, issued a January 2, 1976, letter to SHS commenting on the poor condition of SHS's accounting records and on weaknesses found during the firm's audit. Commenting on the condition of SHS's accounting records, the firm stated:

"Because of the condition of the records and the commingling of grant funds, especially in light of the pre-grant authorization from August 1, 1974 to September 30, 1974 it was impractical to reconstruct the records into proper fund accounting."

Some of the weaknesses noted in the firm's January 2, 1976, letter were as follows:

--In implementing payroll policies, either proper records were not kept to compute vacation pay or proper supervision was lacking in administering vacations.

- Evidence was not found that showed expenditures in excess of \$2,500 had been approved by the Board of Directors as required.
- Checks in excess of \$2,500 were not signed by the president or secretary of the Board as required.
- Control of travel was weak, and records maintained for travel were either nonexistent or in very poor condition.
- No evidence was found that showed travel was approved either by the Board or the Project Director.
- No contracts or agreements were found to authorize consulting fees.
- No support was found for salary or fee reimbursements to SHS from Medical Services, Incorporated. (SHS provided certain employee and other administrative services to Medical Services, a professional corporation of doctors serving SHS.)
- Very little detail was provided, in most cases, to substantiate expenditures.

The firm, in preparing financial statements for its audit report published on January 7, 1976, had to reconstruct SHS financial data by analyzing and classifying individual vouchers. The firm stated in the audit report that it could not express an opinion on the statements of receipts and expenditures because of the lack of proper substantiation and adequate approval to determine the business purpose of several cash expenditures.

At the request of region VIII officials, an audit was also conducted by the HEW Audit Agency. The request was based primarily on the accounting system deficiencies discovered during the November 1975 site visit to SHS by headquarters and regional HMO program officials.

After the C.P.A. firm analyzed and classified financial transactions by income and expense category, the HEW Audit Agency reviewed selected transactions for compliance with grant regulations.

On April 14, 1978, the Audit Agency issued its final report. The report, which covered the same time period (June 1, 1974 to Nov. 30, 1975) as the C.P.A. firm's audit

noted that SHS was "severely deficient" in establishing the necessary financial management systems to account for grant funds and equipment. The Audit Agency noted several deficient financial management practices in administering Federal and local funds:

- Payments were improperly made by SHS after June 1, 1974, for grant expenditures incurred prior to June 1.
- SHS had not established the necessary accounting systems to account for expenditures and matching funds were not properly accounted for or documented.
- Many expenditure vouchers were not signed by the secretary-treasurer and checks in excess of \$2,500 were not signed by the Board president or secretary-treasurer as required by SHS financial policies.
- Formal travel vouchers were not prepared by employees, and documentation was not available to show the Executive Director's or the Board of Directors' approval of trips.
- An equipment control system was not established to account for and control equipment.

The Audit Agency also identified \$1,612.10 in unallowable costs and a \$406.68 fund shortage on the grant balance transferred from Wyoming Health Services to SHS on June 1, 1974.

In commenting on our draft report, HEW Audit Agency officials informed us in March 1978 that they also disclaim an opinion on allowability of matching costs because of inadequate supporting documentation and recommend that SHS either provide such documentation or refund the Federal share of the required matching costs.

Neither the C.P.A. firm nor the Audit Agency's reviews fully addressed the adequacy of SHS accounting system for grant-related income and any premium income it received.

REQUEST FOR AN AUDIT ALLEGEDLY CONTRIBUTED IN PART TO THE PERSONNEL ACTIONS

In September 1976 HEW regional program officials wrote the Chairman, Subcommittee on Health and Scientific Research,

Senate Committee on Human Resources, stating that personnel actions taken against one of the regional program officials, the Regional HMO Program Consultant, 1/ were attributed in part to statements made by an SHS official that were critical of the consultant's conduct toward and assistance provided to SHS. The regional officials' statement is based on the President of SHS April 1976 letter to HEW's Regional Director.

The letter, intended as some closing comments concerning SHS, described the consultant's relationship as "strained" and "unpleasant". The President of SHS indicated that several concerns and, in particular, the handling of the final C.P.A. audit were the primary reasons for the letter. The letter stated that the HMO consultant, during the November 1975 site visit, was highly critical of SHS accounting procedures and the C.P.A. firm's prior audit of SHS for the period ended June 30, 1975. The letter also stated that the consultant improperly intervened in the auditing process on several occasions. In referring to the C.P.A. firm's final audit completed in January 1976, the SHS President stated that he was informed by an HEW Audit Agency official, who reviewed the audit, that minor accounting weaknesses were found.

The Regional Program Consultant wrote the Regional Director on April 28, 1976, in response to the SHS President's letter. The consultant's letter stated that the SHS President threatened him with political pressure and possible legal actions if an audit was requested and nothing was found. The Consultant further noted that, in his judgment, the request for an audit was appropriate. The official request for the HEW audit was made by the Regional Health Administrator on December 2, 1975.

The findings of the C.P.A. firm's audit and the HEW Audit Agency's report confirm that accounting deficiencies precluded a proper accounting for Federal grant funds. Thus, as indicated by the audit findings, we believe that the audit was in order.

We did not address the formal charges against the Regional Program Consultant concerning the Consultant's relationship with SHS and his conduct in the audits because we believe that these personnel actions are internal matters that should be handled by appropriate HEW officials.

1/In May 1976 the Regional HMO Program Consultant was relieved of his duties and in March 1977, reassigned to the headquarters office of the Indian Health Service.

SIMILAR PROBLEMS EXIST

In previous reports we have issued on pre-HMO and HMO program activities, we identified accounting and internal control system weaknesses in several HMO projects similar to those that existed at SHS. In reports issued in May 1974 ^{1/} and November 1975 ^{2/} concerning grantees' use of grant funds and ways to improve HEW management of the grant program, we reported the need for HEW to more closely monitor the financial aspects of grants and assure that prospective grantees have adequate accounting systems with appropriate internal controls to protect the interests of the Federal Government. In the November 1975 report, we identified grant projects in several regions with inadequate accounting and internal control system weaknesses.

In a September 1976 report to the Congress: "Factors that Impede Progress in Implementing the Health Maintenance Organization Act of 1973" (HRD-76-128, Sept. 3, 1976) we reported that HEW did not have the number and type of personnel needed to implement the HMO grant program. This staffing deficiency contributed to the lack of uniformity among the HEW regional offices in reviewing grant awards, monitoring grants, and providing technical assistance to grantees.

HEW has taken some action since the issuance of these reports to improve its administration of the HMO program. However, SHS is another example where HEW continued to inadequately monitor a grantee's compliance with grant administration policies and procedures.

INDICATIONS OF INADEQUATE PROGRESS TOWARD BECOMING OPERATIONAL

Observations made by consultants under contract with HEW and regional program staff indicated that SHS was making little progress toward becoming operational. Other indications were the number of changes in potential starting dates. However, the grant was not terminated until the SHS Board voluntarily voted to withdraw from the program.

^{1/} "Review of Grants to Health Maintenance Organization of South Carolina, Inc." (B-164031(2), May 17, 1974).

^{2/} "Effectiveness of Grant Programs Aimed at Developing Health Maintenance Organizations and Community Health Networks" (MWD-75-98, Nov. 21, 1975).

The grantee hired a consulting firm to assist in developing SHS as an HMO. Reports on a number of visits by the firm's consultants between November 1972 and February 1975 were included in region VIII files on SHS. In a November 1974 meeting, the consultants informed the region VIII program staff that:

- They were concerned about SHS progress with HMO development.
- They believed that most of their visits had not been productive since nothing seemed to change between visits.
- They believed that the SHS Executive Director had become involved in too many side issues resulting in a delay of operations.

Some deficiencies reported in January 1975 by another consultant hired by region VIII were:

- The director of marketing was not capable or qualified to develop a marketing strategy.
- The marketing survey was incomplete, and the market strategy was off schedule by 7 months.
- The proposed basic benefit package did not meet the requirements of HMO program legislation (Public Law 93-222).
- Arrangements for stop loss insurance (protection against insolvency) were not made as required by the HMO legislation.
- Only 3 of 11 tasks scheduled for initiation or completion by the time of the site visit were completed. Significant tasks not completed included determination of capital requirements, finalization of actuarial data, and finalization of reporting systems.
- An overall management plan and a management system for SHS were not completely developed.

A region VIII staff member, following a site visit in December 1974, reported that he believed that the Executive Director was reluctant to initiate action for SHS to become an operationally qualified HMO. Also, he reported his impression that the Executive Director was heavily involved in community activities which were "superficial" to HMO development.

Although SHS set several dates to begin operations, none were met. These dates were:

--July 1, 1974.

--September 1, 1974.

--January 1, 1975.

--Spring 1975.

According to SHS officials, plans to begin operations were not met primarily because of the continued unavailability of grant funds and headquarters officials' advice that SHS not begin operations until it became a federally qualified HMO.

On May 20, 1975, SHS submitted an application for qualification to the Office of HMO Qualification and Compliance. Following a June 1975 site visit, region VIII program staff reported that a great deal of work needed to be done in the next few weeks, but with completion of the activities laid out in the schedule of responsibilities, SHS should essentially be prepared for operational status on July 1, 1975, as planned.

On August 1, 1975, 87 members had been enrolled, but the Federal HMO qualification requirements had not been met. As noted previously, the SHS board voted to withdraw from the program, effective October 31, 1975. The grant was terminated as of November 30, 1975.

OBLIGATION FOR POSSIBLE RETURN OF FEDERAL GRANT FUNDS

On July 26, 1976, the Regional Health Administrator requested the regional attorney's assistance in determining whether SHS was obligated to return Federal grant funds after failing to operate a qualified HMO. The request asked for the regional attorney's interpretation and applicability to SHS of an April 19, 1976, memorandum from the acting director, ¹/division of health maintenance organizations to an HEW region VIII official who raised the issue with headquarters officials concerning another grantee.

The acting director's memorandum stated:

¹/Effective March 1, 1978, HEW appointed a new director of a reorganized Office of HMOs.

"Although the [HMO] Act is silent on a remedy for recovery of expended grant funds, we believe that the Act requires a grantee which demonstrates that the development and operation or expansion of the operation of an HMO is feasible to become a qualified HMO. The Act and regulations clearly impose an obligation on the HMO grantee which demonstrates feasibility that it develop and operate an HMO in accordance with the regulations and the Act."

The act and regulations require each grant application to have in it certain signed assurances that the applicant will develop and operate a qualified HMO. The acting director's April 1976 memorandum, in reference to the required assurances, stated as follows:

"We believe that the Act and regulations clearly bind a grantee for which feasibility has been established to comply with assurances to develop and operate a qualified HMO. Since there is clearly an established legal obligation associated with the signed assurances for planning or initial development costs projects, the applicant should not enter into such an agreement unless there is a total commitment to develop or expand and operate an HMO. A grantee which demonstrates feasibility or satisfies the feasibility or planning requirements and fails to achieve qualification status would be held in violation of these assurances; consequently, we will consider all available remedies, including the possibility that such grantee may be required to return expended Federal grant funds. Of course, the Department will consider the good faith of the grantee and the reasons for non-compliance with the assurances in determining which remedies, if any, to pursue in such an instance."

In February 1978 this same official commented on the HEW Audit Agency draft report and indicated that the question of whether SHS complied with the assurances to develop and operate a qualified HMO was not addressed in the Audit Agency's draft report. He stated that a decision on it should be made before the audit report is issued. As director of the division of health maintenance organizations, he described the HMO program's position as follows:

"If this question is answered negatively, the recovery of all Title XIII grant funds should be undertaken. Compliance with the assurances has been considered met by grantees who have not developed and operated a qualified HMO when it has been determined that the grantee has put

forward its best effort in meeting this requirement. In the case of this grantee, some question exists as to whether such best effort has been made. The basis for this is the denial of qualification which was in part based on lack of [health care] provider arrangements. The audit agency was given provider contracts in addition to the few presented to the Qualification Office. If the absence of these contracts was a primary reason for denial of qualification, then best effort in complying with the assurances was probably not made. Further examination of the grantee's efforts must be undertaken before this question can be answered."

As of June 1978, HEW had not resolved the issue of whether best effort in complying with the assurances was made. The final HEW Audit Agency report noted that the agency did not include an analysis of why SHS did not become qualified in the scope of its review. We agree with the views of the former director of the division of health maintenance organizations that further examination of the grantee's efforts should be undertaken, particularly in regard to whether the provider contracts given to the Audit Agency were also disclosed to the Qualification Office.

AGENCY ACTIONS TO IMPROVE GRANT ADMINISTRATION

HEW has taken some action to try to improve grant administration and prevent the recurrence of similar management deficiencies. Because of insufficient staffing and inadequate monitoring of projects receiving grants in other Public Health Service grant programs, HEW initiated:

- A checklist in January 1975 designed to assist Grants and Contracts Specialists and program staffs in evaluating existing management practices, accounting systems, and internal controls during site visits.
- A followup system to insure timely receipt of grantee expenditure reports at the regional level.

The Regional Health Administrator issued an October 1974 memorandum which described the responsibilities of program managers and grants management specialists. He indicated that both had a responsibility for determining compliance with grant conditions involving financial management but did not state who

had primary responsibility. He told us that he intended that the Grants and Contract Management Branch have primary responsibility for compliance with grant conditions, particularly those involving financial and business management activities.

The Administrator's position was emphasized in April 1976 when a Secretary's task force for improvement of grants administration in HEW issued new manual instructions on "Grants Officer Responsibilities in the Administration of Discretionary Grants." In August 1976 a draft of similar instructions for PHS grants was disseminated to the PHS Grants Management Advisory Committee for review and comment. Both sets of instructions clearly charge the Grants Management Officer with the responsibility for the business and other nonprogrammatic areas of grants administration. These include determining compliance with special grant conditions, adequacy of grantee business management systems and timely expenditure reporting.

The Branch Chief, Grants and Contracts Management Branch, said he planned to establish a followup procedure to assure timely implementation of special grant conditions if the suggested August 1976 PHS guidelines for giving his organization this responsibility were approved.

CONCLUSIONS

Because we could not determine the accuracy and allowability of several grant expenditures from available records and documents, we believe that assurance is lacking that grant funds awarded SHS had been properly accounted for and used in compliance with Government regulations and grant conditions. Because of its inadequate accounting system for grant funds, assurance is also lacking that the grantee properly accounted for all grant-related income and any premium income it received, particularly since neither was fully addressed in the C.P.A. firm's and HEW Audit Agency's reviews.

We believe that inadequate accounting for the use of grant funds continued to exist despite early warnings and several site visits because, prior to the November 1975 visit, either limited or no actual examination of the existing records and documents was made and timely followup was not made to determine compliance with grant conditions.

We did not pursue the issue of lack of progress in developing an operational HMO in much detail because the grant has been terminated and we were primarily concerned with examining the alleged inadequate accounting for grant funds. However, SHS lack of progress existed for some time.

In our opinion, as soon as it becomes apparent that a grantee is not making much progress, the region should reexamine milestones for accomplishing the various tasks and make adjustments, if warranted, in cooperation with the grantee. If a grantee's lack of progress continues, we believe that the grant should be terminated.

Also, when a grantee receives Federal grant assistance for the purpose of developing and operating a qualified HMO, HEW should consider those instances when a grantee has voluntarily withdrawn its qualification application and determine whether the grantee had acted in good faith and was seriously committed to seeking an operationally qualified status. Accordingly, region VIII should continue to pursue this issue in regard to SHS and consider all available remedies, including possible recovery of Federal grant funds.

If actions taken by the agency to improve grant administration are properly implemented and close cooperation and coordination are established and maintained between the Grants and Contracts Management Branch and the program staff, such situations should not recur. To assure proper implementation, we believe that regional instructions need to be expanded to better define the responsibilities of the different organizations and more specifically describe the procedures to be followed. In particular local instructions should be expanded to clearly state that the Grants and Management Contracts Branch will have the primary responsibility to establish the necessary controls to assure timely compliance with business and financial management requirements.

RECOMMENDATIONS TO THE SECRETARY OF HEW

We recommend that the Secretary of HEW direct the Regional Health Administrator to (1) initiate collection of all unallowable grant expenditures incurred by SHS, (2) determine whether SHS had acted in good faith toward becoming a federally qualified HMO, and because of its voluntary withdrawal from the qualification process, whether an obligation exists to return Federal HMO grant funds; and (3) clearly establish management policies and procedures to prevent a recurrence of HEW's grant management problems similar to those identified at SHS.

AGENCY COMMENTS AND OUR EVALUATION

HEW agreed with our recommendations and indicated that it is taking appropriate action. Concerning our recommendation on the need to clearly establish management policies and procedures in administering its grant programs, HEW maintained that:

"With the PHS implementation, effective March 1, 1977, of Grants Administration Manual Chapter 1-03, 'Grants Officer Responsibilities in the Administration of Discretionary Grants,' the responsibilities of the grants management officer are clearly delineated. Further, a recent departmental review of the grants management office in Region VIII concluded that the office has satisfactory systems for managing its grants."

We are not able to comment on the adequacy of the region's present system for managing its grant programs, since we did not conduct a detailed review of its grants management activities. However, the problems the region encountered in its grant administration of SHS were addressed in this report. The region should take sufficient action to prevent similar deficiencies, so that it will not be faced with the same problems encountered with SHS.

HEW did not agree with our finding that SHS continued to be funded despite the region's knowledge that SHS was not making satisfactory progress toward qualification. It maintained that the regional program staff had evaluated the grantee shortly before it withdrew voluntarily from the program and concluded, based on the indicators available at that time, that there was a reasonable prospect that SHS would become a qualified HMO.

We believe that the report sufficiently addresses the findings of SHS inadequate progress by regional staff and consultants under contract with HEW who evaluated the plan's progress toward qualification. We still maintain that SHS lack of progress existed over an extended period of time and thus, consideration should have been made sooner, if not to terminate the grant, at least to assess the region's lack of success in trying to assist this project.



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

April 6, 1978

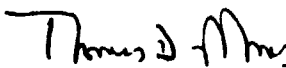
Mr. Gregory J. Ahart
Director, Human Resources
Division
United States General
Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

The Secretary asked that I respond to your request for our comments on your draft report entitled "Problems in Administration of Two Health Maintenance Organization Projects in Region VIII." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,


Thomas D. Morris
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH, EDUCATION, AND
WELFARE ON THE COMPTROLLER GENERAL'S DRAFT REPORT
ENTITLED "PROBLEMS IN ADMINISTRATION OF TWO HEALTH
MAINTENANCE ORGANIZATION PROJECTS IN REGION VIII"

GENERAL COMMENTS

The Department generally concurs with the recommendations of the General Accounting Office (GAO). In fact, many of the criticisms reported by GAO had been noted during a review conducted by the HEW Audit Agency (HEWAA) and actions have been initiated or planned that will result in claims against the grantees for recovery of funds, as well as other corrective measures. We do not, however, agree totally with some of GAO's conclusions on issues not addressed in the recommendations.

The draft report implies that the regional office acted inappropriately in allowing the grantee to use grant-related income to construct a facility. Although it may be concluded that some of the income should not have been included in the reserve, there is no prohibition to establishing such a contingency reserve. Further, GAO endorses the outcome of the use of the reserve by its statement on page 32: "However, since the medical clinic is operating in accordance with its intended purpose, we agree with HEW's decision to continue to operate the medical facility to serve low income patients."

[See GAO Note.]

In addition, we do not agree with the implication that Sweetwater Health Services, Inc. (SHS) continued to be funded even though the regional staff knew that SHS was not making satisfactory progress toward becoming a federally qualified Health Maintenance Organization (HMO). The regional program staff had evaluated the grantee shortly before it withdrew voluntarily from the program and concluded, based on the indicators available at that time, that there was a reasonable prospect that SHS would become a qualified HMO.

GAO RECOMMENDATION

We recommend that the Secretary of HEW direct the Regional Health Administrator to determine the amount of and, if appropriate, initiate collection of the interest earned on grant funds by NHC and its successor organizations.

DEPARTMENT COMMENT

We concur. The grantee has been notified in writing that the interest earned on grant funds would have to be refunded. Following our determination of the exact amount to be refunded, collection actions will be initiated.

- 2 -

GAO RECOMMENDATION

We recommend that the Secretary of HEW direct the Regional Health Administrator to (1) determine the amount of and initiate collection of all unallowable grant expenditures incurred by SHS and (2) determine whether SHS had acted in good faith toward becoming a federally qualified HMO, and in view of its voluntary withdrawal from the qualification process, whether an obligation exists to return Federal HMO grant funds.

DEPARTMENT COMMENT

We concur and appropriate action is underway.

GAO RECOMMENDATION

We recommend that the Secretary of HEW direct the Regional Health Administrator to clearly establish management policies and procedures to prevent a recurrence of HEW's grant management problems similar to those identified at SHS.

DEPARTMENT COMMENT

We concur. With the PHS implementation, effective March 1, 1977, of Grants Administration Manual Chapter 1-03, "Grants Officer Responsibilities in the Administration of Discretionary Grants," the responsibilities of the grants management officer are clearly delineated. Further, a recent departmental review of the grants management office in Region VIII concluded that the office has satisfactory systems for managing its grants.

GAO Note: Page references in this appendix refer to the draft report and do not necessarily agree with the page numbers in the final report.

PRINCIPAL HEW OFFICIALS RESPONSIBLE FOR
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of Office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF HEW:		
Joseph A. Califano, Jr.	Jan. 1977	Present
David Mathews	Aug. 1975	Jan. 1977
Caspar W. Weinberger	Feb. 1973	Aug. 1975
Frank C. Carlucci (acting)	Jan. 1973	Feb. 1973
Elliot L. Richardson	June 1970	Jan. 1973
ASSISTANT SECRETARY FOR HEALTH:		
Julius Richmond	July 1977	Present
James F. Dickson III (acting)	Jan. 1977	July 1977
Theodore Cooper	May 1975	Jan. 1977
Theodore Cooper (acting)	Feb. 1975	Apr. 1975
Charles C. Edwards	Mar. 1973	Jan. 1975
Richard L. Seggel (acting)	Dec. 1972	Mar. 1973
Merlin K. Duval, Jr.	July 1971	Dec. 1972
REGIONAL HEALTH ADMINISTRATOR, HEW REGION VIII:		
Hilary H. Connor	June 1974	Present
Hilary H. Connor (acting)	Mar. 1974	June 1974
Abel Ossorio (acting)	Aug. 1973	Mar. 1974
REGIONAL HEALTH DIRECTOR, HEW REGION VIII:		
Abel Ossorio	Oct. 1972	Aug. 1973
Dean Hungerford (interim)	July 1971	Oct. 1972

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